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CITY OF OAKLAND
Inter-Office Letter

new

To: City Manager Attention: Mr. Cecil S. Riley Date February 20, 1973

From: Finance Office

Subject: REVENUE SHARING

On December 11, 1972, the City of Oakland received a payment in the amount of $2,304,155, representing the Revenue Sharing allocation for the period January 1972 - June 1972.

On January 8, 1973, the City received a second payment in the amount of $2,211,058, representing the Revenue Sharing allocation for the period July 1972 - December 1972.

These sums are Oakland's share of a nationwide distribution of $5.3 billion. To date, the State of California has received over $181,000,000 (for its own unrestricted uses) and the County of Alameda has received approximately $9,376,000. Cities in Alameda County have received an additional $9,100,000. Oakland's allocation of $4,515,000 is almost 50% of the total distributed to all Alameda County cities.

The implementation of the Revenue Sharing program presents a different opportunity for every unit of government receiving these funds. For the State of California, it is totally new money available for any purpose. Through SB 90, the "Property Tax Relief Act of 1972", the State has already allocated its Revenue Sharing funds to provide homeowner property tax relief and to provide substantially increased state support for education. For many counties in California, including Alameda County, Revenue Sharing funds may not prove nearly as beneficial. The counties are faced with substantial cutbacks in federal support for health and welfare programs and may have to determine whether to discontinue certain programs, decrease service levels, or provide funds from their Revenue Sharing allocations to maintain such programs and services.

Cities present the most varied picture. Some begin this period with a budget balanced to current income and can forecast a growing tax base to keep pace with rising expenditures. Cities in this situation are free to regard Revenue Sharing as new money. They can afford to make decisions about its use without fear of having to raise taxes. Such cities will most likely consider one-time capital improvements rather than increasing the level of operating expenditures since it is conceivable that the Revenue Sharing program may not be continued beyond 1976.

Many other cities begin this period with a budget which is not balanced to current income. Recent budgets may have been balanced from accumulated reserves, reductions in working capital to minimal levels, reductions in budgeted contingency levels, and other similar steps which can be utilized only once. Further, these cities cannot forecast a growing tax base which will keep pace with future expenditure requirements. Such cities are not

free to treat Revenue Sharing apart from their basic operating needs unless they are prepared to enact substantial tax increases over the next few years. This is the situation which Oakland faces.

As has been concluded in an earlier report submitted to the City Council, the newfound wealth of Revenue Sharing is, for Oakland, more apparent than real. None of the Revenue Sharing funds can be truly considered as available for new purposes unless the City is prepared to increase local taxes (a property tax increase is potentially made difficult by SB 90). Indeed, we must conclude that the City will have to find additional tax resources over the period of the next three fiscal years even if all Revenue Sharing funds are dedicated for maintenance of existing services.

PROJECTION OF REVENUE SHARING ALLOCATION

The projection of future Revenue Sharing allocations is extremely difficult. Oakland's distribution will be dependent on numerous other factors, most of which are beyond our control. However, with the awareness that our estimates will have to be constantly updated, it is possible to make a reasonable projection based on the continuance of observed trends.

The nationwide allocation provides for an increasing sum to be distributed for each entitlement period (basically a one-time 9% increase for 1973 and a 2.5% annual growth factor in partial consideration of expenditure increases due to inflation). We expect that the total Revenue Sharing allocation to the State of California will increase in accordance with these percentages. Variations in distributions to local governments will be based primarily on changes in population and changes in locally-raised taxes. It is projected that Southern California will continue to grow more rapidly (both in population and tax revenues) than this region. Similarly, allocations within Alameda County will reflect the more rapid growth of the south-county area. Table I shows the allocations we have estimated for each entitlement period based on the foregoing considerations.

For the 5-year period of the Revenue Sharing legislation, it is estimated that the City of Oakland will receive $23,115,000. As the Council has been advised, this is considerably less than the City was initially led to expect. We had been informed in October that our allocation for calendar 1972 would be $5,775,000. Instead, it was $4,515,000. The difference is attributable to the updating of revenue figures from 1966 to 1971 and to a large extent the amount "lost" by Oakland was "gained" by other cities in the southern portion of the county.

FISCAL PROJECTION

Table II summarizes the City's expected financial position over the next three fiscal years. Projection of revenues and expenditure requirements were made in substantial detail. However, only the overall deficit projections are shown for simplicity.

Our study has indicated that we may anticipate a deficit for the three-year period ranging from about $22.5 million to over $30.5 million. This is the

amount by which expenditures required to continue existing services will exceed our financial capacity assuming current rates of taxation.

Section B of Table II shows the total amount of Revenue Sharing funds which will be available within this time period. The estimate of interest earnings is minimal. As the note on Table I explains, such earnings will be highly dependent on how the Revenue Sharing funds are used.

Section C of Table II shows that additional tax resources will be required even if all Revenue Sharing funds are applied to meet the deficit. The property tax rate equivalent is shown to indicate the magnitude of the financial problem,although other alternatives would be available (such as service cutbacks).

PERMITTED USE OF FUNDS

As the Council has previously been advised, the legislation imposes certain restrictions on the use of Revenue Sharing funds by local government. To reiterate, the permitted "priority" categories are as follows:

1. Ordinary and necessary maintenance and operating expenses for:

   (a) public safety (including law enforcement, fire protection and building code enforcement)
   (b) environmental protection
   (c) public transportation
   (d) health
   (e) recreation
   (f) libraries
   (g) social services for the poor or aged
   (h) financial administration

2. Ordinary and necessary capital expenditures authorized by law

There is a specific prohibition that funds may not be used for matching purposes, either directly or indirectly, in order to obtain any other federal funds. This condition will probably require the City to positively identify all matching funds in the budget process. The prohibition against "indirect" matching has not yet been clearly defined by the Treasury Department.

It has been noted previously that school purposes have not been included as a permitted category of local expenditure. The allocation formula for local government specifically excludes school taxes (either imposed by the school system directly or by any other unit of government for school use) from calculation of tax effort. The City Attorney has expressed his opinion that were the City to support the school system from its general fund, the Treasury could construe this action as an indirect tax for school purposes and reduce the City's local tax revenue amounts by a like sum. This in turn would reduce the City's tax effort factor and thus its

Revenue Sharing allocation. If, for example, the City had provided $2 million to the school district in 1972, its calendar 1972 Revenue Sharing allocation might have been reduced by $160,000.

It is clear that Congress felt the problems of school finance required separate consideration. It is also observed that the State of California, through passage of SB 90, has provided a substantial portion of its Revenue Sharing allocation for support of local schools. Further, the state has pronounced that SB 90 is not the final step in restructuring school financing. The Act includes the following statement:

> "It is the intent of the Legislature that an interim study be conducted on wealth equalizing among school districts; including but not limited to such means of wealth equalizing as variable foundation programs, power or wealth equalizing and wealth pulling."

REPORTING REQUIREMENTS

Each entitlement must be spent, obligated or appropriated within 24 months of receipt. A report on the use of the first entitlement must be submitted to the Secretary of the Treasury by March,1, 1974. Report forms and instructions for subsequent entitlement periods have not yet been received. However, the following general rules should apply:

1) Planning reports will be submitted for the third entitlement period (January - June 1973) and for each subsequent period. These reports will describe the intended use of each allocation.

2) Expenditure reports will be required for each entitlement period (including the first two periods).

3) All reports are to be published in a local newspaper of general circulation, and the City government is required to advise the news media of the publication.

These rules will require the City Council to make specific decisions regarding each entitlement period. Although we are initially reviewing the needs of the City over the entire time period, specific allocations can be handled within the context of each budget.

SB 90

Among its many other provisions, SB 90 imposes a limitation on local property tax rates. Cities are restricted to the property tax rate in effect for the 1972-73 fiscal year, exclusive of the rate for bond interest and redemption charges (this would permit a rate of $2.8121 for Oakland). The legislation provides several alternative means of exceeding the specified property tax rate ceiling:

1) The property tax levy can increase in the same percentage as the combined percentage increase in population and the Consumer Price Index (note that this provision inhibits any voluntary tax rate reductions, since in ensuing years the permissible increase is limited).

2) An additional rate may be levied to pay for any costs which are mandated by the federal government or the courts and which are not funded by the federal or state government.

3) The maximum tax rate may be changed by a majority of those voting in an election called for such purpose.

The legislation further provides that the State will fully reimburse any local revenue loss caused by future property tax exemptions or sales and use tax exemptions, and that the State will pay the cost of any State-mandated program or increased level of service enacted after January 1, 1973 (although the accounting requirements placed upon the City to recover such amounts may prove as costly as the reimbursements).

The tax limitation provision appears to pose a problem, except that there are two general exclusions. The City may levy a rate in excess of the limitation for (1) the payment of validly contracted bonded indebtedness and interest thereon, and (2) for the payment of retirement and pension benefits pursuant to laws which have been,or may in the future be, approved by the voters.

We have been advised by the City Attorney that the latter exclusion would allow us to finance the entire General Fund cost of retirement through a tax rate in excess of the $2.8121 limitation. In the 1972-73 budget, this cost amounted to $12,572,000. This sum would permit a tax rate about $1.25 above the 1972-73 level.

As presently written, the tax rate limitation affords the City a great deal of latitude. We are aware, however, that SB 90 may be subject to major review and amendment in the current session of the legislature. It is not possible to judge whether the tax rate limitation provision will remain as flexible as it now appears.

FEDERAL PROGRAM REDUCTIONS

It has been widely publicized that the President's Budget, if adopted, will terminate a great number of social programs. Oakland would surely be affected by these reductions, but it is not yet possible to determine the impact. In most cases, termination or reduction of federal program support would not be offset by new local support. To this extent, the community would suffer a loss but the City's budgetary problem would not be worsened. However, in some cases, lack of federal support will affect City revenues (e.g. from the Housing Authority) or may force the City to provide local funding.

At this point, we can only list the major federal programs now operated by the City.

Program	Contract Amount	Commenced	Termination
Model Cities	$4,944,000	4/1/72	3/31/73
(We have been advised by HUD Area Director that the grant for the next action year will be substantially reduced)			
Emergency Employment	$ 967,831	9/1/72	3/15/73
(We expect this program to be extended on a monthly basis until August, and then terminated)			
Concentrated Employment	$1,562,867	1/1/73	12/31/73
Community Action Agency	$ 628,000 *	11/1/72	10/31/73
Headstart	$ 324,200	9/1/72	8/31/73
NYC - Out of School	$ 541,267	8/24/72	4/11/73

RECOMMENDATIONS

Considering the City's projected financial condition, and the uncertainty surrounding federal program support and State tax rate limitation measures, it is recommended that the City Council consider utilizing all Revenue Sharing funds in support of existing operating programs. This policy will serve to minimize the need for future tax increases, although it would not preclude the reordering of priorities within budgetary constraints. For administrative convenience, Revenue Sharing funds could be allocated entirely to public safety expenditures.

If the Council should determine that some portion of Revenue Sharing funds shall be used for new expenditures, it is recommended that only capital projects be considered since new operating programs will necessarily involve inflationary cost increases each year.

It is further recommended that the property tax rate be maintained at the existing rate of $2.91. This recommendation is made for two reasons:

(1) The provisions of SB 90, as presently written and as it may be amended, inhibit voluntary tax rate reductions. If the City were to lower the tax rate to the maximum extent possible for 1973-74, we might find that we are unable to raise the tax rate to a level sufficient to meet budget needs in future years. The uncertain status of SB 90 at least argues for caution in this regard.

* This amount represents funding only for the first six months of the contract period, through April 30, 1973.

(2) Reduced property tax revenues will be reflected in reduced Revenue Sharing allocations, unless all cities and counties pursue the same policy. Our future entitlements and budget deficits have been projected based on continuance of the present property tax rate.

SUMMARY

In the most basic terms, every dollar of Revenue Sharing funds used for a new program or project or to expand an existing service will require a corresponding reduction in some program, project or service level presently financed. Alternatively, the projected deficit will be increased.

Within the next three fiscal years, the City of Oakland will be faced with the prospect of finding new sources of revenue or increasing the tax rates of existing sources. The decisions made on the use of Revenue Sharing funds will determine the magnitude of this future need.

Robert M. Odell, Jr.
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Finance Director-Treasurer

APPROVED AND FORWARDED
TO THE CITY COUNCIL

Cecil S. Riley
City Manager

RMO:ATL:d

Attachments: TABLE I - Estimated Revenue Sharing Allocations
City of Oakland
1972 - 1976

TABLE II - Financial Projection
Through Fiscal Year 1975-76

Summary of Recommendations

TABLE I

Estimated Revenue Sharing Allocations
City of Oakland
1972 - 1976

Entitlements:

Period	Amount
January - June 1972	$ 2,304,155 (actual, received December 1972)
July - December 1972	2,211,058 (actual, received January 1973)
January - June 1973	2,450,000
Total-Fiscal Year 1972-73	$ 6,965,000 (rounded off)
July 1973 - June 1974	$ 4,600,000
July 1974 - June 1975	4,600,000
July 1975 - June 1976	4,600,000
July 1976 - December 1976	2,350,000
Total-Five Years	$23,115,000

NOTE: Investment of Revenue Sharing funds will earn about $150,000 (not shown above) by the end of the current fiscal year. Interest earnings must be deposited in the Revenue Sharing Fund and are subject to the same expenditure restrictions.

The amount of interest to be allocated to the Revenue Sharing Fund in future years will depend on how rapidly these funds are used. If they are used for "ordinary and necessary" operating expenditures, the average cash balance would be minimal and interest earnings would accordingly be insignificant.

TABLE II

Financial Projection
Through Fiscal Year 1975-76

A. Anticipated Shortage of Current Income to Maintain Existing City Services:

Fiscal Year	Optimistic Estimate	Conservative Estimate
1973-74	\$- 6,535,000	\$- 7,665,000
1974-75	- 7,430,000	-10,100,000
1975-76	- 8,480,000	-12,880,000
Total Deficit-Three Years	\$-22,445,000	\$-30,645,000

Basis for Optimistic Estimate - revenues to increase 3.5% per year
expenditures to increase 4.5% per year

Basis for Conservative Estimate- revenues to increase 2.75% per year
expenditures to increase 6% per year

B. Available Revenue Sharing Funds through June 1976:

Total Allocation Estimated through June, 1976	\$20,765,000
Total Interest Earnings anticipated through June, 1976	150,000
	\$20,915,000

C. Additional Tax Resources Required over the Three-Year Period if <u>all</u> Revenue Sharing Funds are used to help Maintain Existing Services:

	Optimistic Estimate	Conservative Estimate
	\$ 1,530,000	\$ 9,730,000
In terms of Property Tax Rate	15¢	97¢

Summary of Recommendations

1. Use Revenue Sharing funds to support existing level of City expenditures. Priorities can be reordered within this constraint.

2. If any Revenue Sharing funds are to be used for new expenditures, they should be limited to one-time capital improvements which would not involve significant continuing operating costs.

3. The property tax rate for 1973-74 should be maintained at the existing rate of $2.91. The intent of this recommendation is to minimize the need for future tax increases.